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ABSTRACT

This report on abuses in federal student aid programs, particularly the Guaranteed Student Loan Program (GSLP), is based on information gathered by the Senate Permanent Subcommittee on Investigations in the course of its overall investigation and the testimony and exhibits received during the course of hearings held between February and October, 1990. The hearings, taking place over 8 days, involving nearly 50 witnesses, and dealing with the overall GSLP status, were organized around case studies, specifically: The American Career Training Corporation of Pompano Beach, Florida; The Culinary School of Washington, D.C.; and the collapse of the First Independent Trust Company of Sacramento, California. This investigation was prompted by a large volume increase in the program, a dramatic increase in loan defaults, and reports of waste, fraud and abuse within the GSLP. In four sections the following topics are addressed: the nature and extent of the program (GSLP growth, business over education, industry profits, problem schools, students as victims); the existence of serious problems at all levels (school practices, state licensure, accreditation, financial players); the dismal record of the U.S. Department of Education (failures to monitor eligibility and certification, accrediting agency recognition, financial player regulation/oversight, administration/management, enforcement). A final section offers findings, conclusions, and recommendations. (JB)

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102D CONGRESS
1st Session

SENATE

REPORT
102-58

ABUSES IN FEDERAL STUDENT AID PROGRAMS

REPORT

MADE BY THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
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Mr. GLENN, from the Committee on Governmental Affairs
submitted the following

REPORT

I. INTRODUCTION

Established in 1965, the Guaranteed Student Loan Program authorized by Title IV of the Higher Education Act attempted, as described by then-President, Lyndon Johnson, "to provide access to every student who wants to better himself through higher education." Through fiscal year 1989, more than 48 million guaranteed student loans worth over $100 billion were obtained by borrowers attending postsecondary education institutions—4-year colleges and universities, 2-year community colleges, and business, trade, technical and other vocational schools. About 9.6% of this amount has been lost through default.

Recent trends have prompted serious concern over the Guaranteed Student Loan Program's (GSLP) cost-effectiveness and ongoing viability. For example, between fiscal years 1983 and 1989, annual loan volume almost doubled, from $6.8 billion to $12.4 billion. During this same period, loan defaults increased by 338%—four times greater than the increase in loan volume—from $444.8 million to just under $2 billion. As a result, the cost of defaults, as a percentage of all GSLP program costs, rose from about 10% in FY 1980 to 36% in FY 1989, and to more than 50% in FY 1990. In other words, currently more than half of the government's GSLP cost is going to pay for defaulted loans from the past rather than to subsidize education and training for today's students.

Prompted by reports of skyrocketing default costs and increasing instances of waste, fraud, and abuse in the GSLP, Senate Permanent Subcommittee on Investigations Chairman Sam Nunn, with the concurrence of the Ranking Minority Member, William V. Roth, Jr., initiated an investigation in the fall of 1989. Both the U.S. General Accounting Office (GAO) and the Office of Management and Budget had identified Federal student loan programs as

being among those government efforts they believed to be "high risk" in terms of their vulnerability to waste, fraud, and abuse.

At the outset of the investigation it became clear that a markedly disproportionate amount of problems in the GSLP seemed to be attributable to proprietary school student borrowers.[1] The GAO, for example, determined that while proprietary school students comprised about 22% of all GSLP borrowers who received their last loan in academic year 1983, they accounted for 44% of defaulters as of September 30, 1987. Over that period, the student default rate for proprietary schools was 39%, as contrasted to a 10% rate for four-year public and private schools. Linking these early findings to the fact that the most significant growth in GSLP volume in the 1980s was occurring in the proprietary school sector, the Subcommittee focused its investigation on allegations of waste, fraud, and abuse in the program's proprietary school sector operations.

Between February and October, 1990, the Subcommittee held a series of hearings to examine allegations of fraud and abuse on the part of some of the key participants in the GSLP, i.e., proprietary schools, lenders, loan servicers, secondary markets, and guaranty agencies. The hearings also focused on the role of the U.S. Department of Education in administering and overseeing its GSLP responsibilities and on the parts played by other major program participants, including student borrowers, State licensing authorities and independent agencies that accredit proprietary schools.

The hearings encompassed eight days, over the course of which testimony was received from nearly 50 witnesses from across the spectrum of participating GSLP interests and individuals. In addition to concentrating on overall GSLP problems, the hearings were organized around several case studies, specifically:

(1) The American Career Training Corporation (ACT) of Pompano Beach, Florida, a part-correspondence (home study), part in-residence school with courses for secretaries and travel agents. Between 1985 and 1989, ACT students received in excess of $150 million in federally guaranteed loans;

(2) The Culinary School (CSW) of Washington, D.C., a school offering training for would-be chefs. Despite numerous, persistent, and serious problems over an eight year period—during which time its cumulative student loan volume reached $19 million—CSW retained its eligibility to participate in the GSLP; and

(3) The collapse of the First Independent Trust Company (FITCO) of Sacramento, California, at one time the nation's second leading GSLP lender. Over the nine-year period 1980–1989, FITCO originated an estimated $1.5 billion in guaranteed student loans, the vast percentage of which were made to proprietary school students.

The hearings, and the year-long Subcommittee investigation of which they were a part, were conducted pursuant to Senate Resolution 66, adopted February 28, 1989. This Resolution authorizes the Subcommittee to examine, among other things, "the efficiency and economy of operations of all branches of the Government." Included in this context is the authority to look into the existence of pos-

[1] Throughout this report, the term "proprietary schools" refers to private, for-profit trade and other vocational institutions that provide postsecondary education.

sible fraud, mismanagement, unethical practices, waste, conflicts of interest, and the improper expenditure of Government funds in connection with transactions, contracts, and other Federal activities. The Resolution further provides that the Subcommittee can examine the compliance or noncompliance of those individuals and entities doing business with the government with the rules, regulations, and laws governing the various governmental agencies and their relationship with the public.

This report is based on information gathered by the Subcommittee in the course of its overall investigation and the testimony and exhibits received during the course of the hearings.

II. THE GUARANTEED STUDENT LOAN PROGRAM

A. What it is

The Guaranteed Student Loan Program is one of seven major student financial aid programs administered by the Department of Education, established pursuant to Title IV of the Higher Education Act of 1965, as amended. It provides for three types of loans:

(1) Stafford—low interest loans that are made on the basis of financial need. The government pays interest on the loan while students are in school and students typically begin repayment within six months of leaving school. The maximum loan limit for undergraduate education, including proprietary school students, is $17,250 ($2,625 annually for the first two years and a maximum of $4,000 annually for the next three years). In fiscal year 1988, proprietary school students accounted for $2.6 billion (30%) out of the $8.8 billion for all Stafford loans for that year;

(2) PLUS (Parent Loans for Undergraduate Students)—loans that are not need-based, which enable parents to borrow funds for a dependent student enrolled at a school. Interest rates on PLUS loans are variable, with a current ceiling of 12%, and the maximum loan amount is $4,000 annually, up to a total of $20,000. Repayment on these loans generally begins within 60 days after disbursement. In fiscal year 1988, parents of proprietary school students accounted for $134 million (26.6%) out of the $503 million borrowed in total PLUS Loans that year; and

(3) SLS (Supplemental Loans for Students)—loans to students who are not dependent on parental support. These loans are also not need-based and generally have the same interest rate, borrowing limits, and repayment requirements as that applicable to PLUS loans. As a result of the Student Loan Reconciliation Amendments of 1989, proprietary school and undergraduate students attending institutions with default rates of 30% or more are no longer eligible for SLS loans, unless they had already received such a loan at the school prior to the law's enactment. In fiscal year 1988, proprietary school students accounted for $1.04 billion (61.2%) out of the $1.7 billion borrowed in SLS loans that year.

B. How it works

In order for a student to receive a guaranteed student loan, the Department of Education must have determined that the school he or she is attending is eligible to participate in the GSLP. This eligi-

bility is based on a determination by the Department that the subject school has been:

(1) licensed to operate in the State in which it is located. Licensing typically requires the disclosure of information, the public availability of which will presumably be used by prospective students to make informed decisions about where to enroll;

(2) accredited by a nationally recognized agency approved by the Secretary of Education. The Department relies on officially recognized accrediting bodies to assure that accredited schools provide a "quality education" for students who enroll in them. Of the approximate 100 accrediting bodies recognized by the Secretary, seven accredit the vast majority of proprietary schools receiving GSLP funds;[2] and

(3) approved by the Education Department to participate in the GSLP. Approval requires a finding that the school is eligible under statutory criteria, which include that it has been licensed and accredited. In addition, the school must meet Departmental certification requirements, including a determination that it has the financial and administrative capability to participate. Every four years, the Department requires that approved schools reapply to continue their eligibility.

Generally, the student initiates the loan process by applying at the school.[3] The school certifies the student's eligibility, whereupon the application is submitted to a participating GSLP lender.[4] In some instances, schools enter into agreements with guaranty agencies and accordingly use lenders insured by the latter.

Lenders (which can include banks, savings and loans, credit unions, trust companies, pension funds, insurance companies, State agencies, some schools, and guaranty agencies) make the loan and are required to exercise proper care regarding their servicing and collection. Lenders bill the Education Department each quarter for interest the Federal government pays on behalf of students with Stafford loans. Also, for the life of the loan, lenders receive a "special allowance," currently 3.25% above the 91-day Treasury Bill, which acts as an incentive to keep them in the GSLP by subsidizing the low interest rate borrowers pay. According to GAO, some 13,000 participating GSLP lenders were holding about $45 billion in outstanding loans as of September 30, 1988,

Third-party loan servicers are in many instances retained by lenders to carry out the servicing and collection functions, for which the lenders are responsible. Loan servicers, for example, keep track of the student, send out monthly bills, credit payments

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[2] The seven are the: Accrediting Bureau for Health Education Schools (ABHES); Accrediting Commission for Continuing Education and Training (ACCET); Association of Independent Colleges and Schools (AICS); National Association of Trade and Technical Schools (NATTS); National Accrediting Commission of Cosmetology Arts and Sciences (NACCAS); National Home Study Council (NHSC); and Southern Association of Colleges and Schools, Commission on Occupational Education Institutions (SACS/COEI).

[3] According to Federal law, when applying for Federal student financial aid, a student must first be considered for a Pell Grant before being eligible for consideration for either a Stafford Loan and/or Supplemental Loan for Students.

[4] By statute, the Department of Education is prohibited from requiring schools to verify more than 30% of student aid applicators. To ensure that the 30% limit is not exceeded, the Department uses selection criteria that enables it to focus on the most error-prone applications. Verification is aimed at assuring the accuracy of the information provided by the student and the student's family. A student can be required to produce income tax and other documentation to confirm this information.

to the student's account, and implement so-called "due-diligence" requirements when a loan becomes delinquent. As of September 30, 1988, loan servicers were administering at least $18.6 billion (41%) of the $45.1 billion in outstanding guaranteed student loans.

Some lenders sell the loans they hold on the secondary market. There are presently some 50 secondary market organizations for student loans in the U.S., making additional capital available to lenders so that they can make more loans. While loans may be bought and sold on the secondary market more than once, the original guarantee stays with the loan for the life of the loan. As of September, 1988, secondary market organizations held approximately $18.4 billion (40%) of the outstanding guaranteed student loan portfolio.

Guaranty agencies issue guarantees on loans so that when a borrower fails to repay the loan due to death, disability, bankrupcty, or default, the lender incurs no loss. Lenders file default claims with the guaranty agency after borrowers have been delinquent for at least 180 days. These guarantees are conditional, in that if a lender fails to exercise the required servicing and/or collection procedures, the agency and/or the Education Department can refuse to pay the claim. The Department reimburses the guaranty agencies for up to 100% of lenders' claims, but, when default losses reach certain levels, may reduce the amount of reimbursement to 90% and even 80%.[5]

In addition, guaranty agencies: charge the borrower an insurance premium of up to three percent of the loan to help offset their program administration costs; collect a one percent administrative cost allowance from the Department of Education; verify that lenders have properly serviced and/or attempted to collect on loans before paying default claims; conduct program reviews of lenders and schools; and, remit to the Department of Education 65% or 70% of any monies collected from defaulted borrowers. Guaranty agencies become the "lender of last resort," when other lenders choose not to make loans to eligible students. There are 55 guaranty agencies, comprised of state entities and private non-profit organizations, nationwide.

The Department of Education is responsible for administering the GSLP and for overseeing the activities of the various participants. The Department's major responsibilities include:

(1) initial certification and periodic review of officially recognized accrediting bodies;

(2) periodic program compliance reviews of schools, lenders, and guaranty agencies;

(3) enforcement actions, such as limiting, suspending and/or terminating student financial aid eligibility, in instances when non-compliance, abuse, and/or fraud are detected in participants' activities; and

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[5] By statute, the Secretary of Education is authorized to reimburse guaranty agencies for up to 100% of its losses on loan defaults. However, if the total reinsurance claims paid by the Secretary to a guaranty agency during any fiscal year reaches 5% of the amount of loans in repayment at the end of the preceding fiscal year, the Secretary's reimbursement equals 90% of that agency's default losses. Similarly, when reinsurance claims reach 9%, reimbursement drops to 80% of the agency's default losses.

(4) establishing and maintaining complete and current data on participating schools, lenders and guaranty agencies.

III. THE NATURE AND EXTENT OF THE PROBLEM

The Subcommittee investigation uncovered overwhelming evidence that the GSLP, particularly as it relates to proprietary schools, is riddled with fraud, waste, and abuse, and is plagued by substantial mismanagement and incompetence. Despite the acknowledged contributions of the well-intended, competent, and honest individuals and institutions comprising the large majority of GSLP participants, unscrupulous, inept, and dishonest elements among them have flourished throughout the 1980s. The latter have done so by exploiting both the ready availability of billions of dollars of guaranteed student loans and the weak and inattentive system responsibile for them, leaving hundreds of thousands of students with little or no training, no jobs, and significant debts that they cannot possibly repay. While those responsible have reaped huge profits, the American taxpayer has been left to pick up the tab for the billions of dollars in attendant losses.

A. GSLP growth

1. Changes in the program

During the 1980s, major changes were made in federal student aid programs. Rising educational costs and severe budget shortfalls led to greater emphasis on financial need and a shift from grants to loans as the dominant type of student financial aid. These changes vastly increased accessibility to proprietary school students which, in turn, fueled phenomenal growth in the number of GSLP borrowers and the overall loan volume they generated.

For example, in the late 1970s and early 1980s the Higher Education Act (HEA) was amended to allow more students who have not completed high school or its equivalent to receive student aid if it has been determined that they have the ability to benefit from the training offered by a postsecondary education institution. In the HEA Amendments of 1986, annual and aggregate loan limits were increased in the Stafford (from $2,500 to $2,625) and Supplemental Loans for Students (SLS, [from $2,500 to $4,000]) programs. As pointed out in testimony by the Executive Director of the California Student Aid Commission (CSAC), the 1986 Amendments resulted in a virtual "available for the asking" policy on SLS loans, since they removed prior limitations on proprietary school borrowers, provided an exemption from multiple disbursement requirements, and minimized the application process.

Moreover, the so-called "Technical Amendments of 1979" helped to encourage lenders to market loans to proprietary school students for the first time. These Amendments removed a ceiling on the special allowance interest subsidy paid to participating GSLP lenders, thereby making proprietary school loans, which had previously been considered as too risky, more attractive.

2. Statistical indicators

Statistical indicators of the dramatic growth experienced within the GSLP are readily apparent. For example, while proprietary

school borrowers received about $915 million in Stafford loans for 1983, this amount more than doubled to about $2.8 billion in 1988. The number of proprietary school loans increased during the same five-year period from about 490,000 to 1,230,000. Similarly dramatic growth took place regarding SLS loans. According to GAO, proprietary school students accounted for slightly more than 8% of all SLS borrowers in 1986, 50% in 1987, and more than 61% in 1988. Between 1982 and 1988, overall GSLP (Stafford, PLUS, and SLS) volume for proprietary schools increased more than six-fold, from $684 million to $4.15 billion.

Case studies examined by the Subcommittee underscored the growth in the GSLP. For example, the American Career Training Corporation's (ACT) student loan volume from 1985 to 1988 went, respectively, from $4.7 million to nearly $45.5 million—an increase of almost ten-fold. Overall, from the point in 1985 at which ACT became eligible to participate in the GSLP through 1989, its students received loans totaling $153.3 million. The number of students receiving these loans increased correspondingly from just over 2,000 in 1985 to a peak of more than 18,000 in 1988.

Largescale increases in loan activity among the GSLP's financial players also occurred throughout the 1980s. In the case of the First Independent Trust Company of Sacramento, California (FITCO), for example, from the time it began to participate in the GSLP in 1980 through its closing in 1989, it originated an estimated $1.5 billion in student loans—the vast majority of which went to proprietary school students. FITCO's loan volume grew so extensively that it became the largest GSLP lender in California and, for a time in 1987 and 1988, the second largest GSLP lender nationwide.

Such growth among lenders impacted others in the financial chain, e.g., guaranty agencies, secondary market institutions, and loan servicing organizations. In the case of the Higher Education Assistance Foundation (HEAF), fueled by an enormous expansion in its proprietary school portfolio, its annual volume of GSLP loan guarantees grew from less than $900 million in 1984 to nearly $3.3 billion in 1988. Between 1986 and 1988, well over half the loan guarantees issued by HEAF were for proprietary school students and by that latter year it had become the nation's largest guarantor (accounting for 27% of all student loan guarantees issued that year).[6] The California Student Loan Finance Corporation (CSLFC), acting as a secondary market, saw its portfolio of GSLP loans grow from its inception in 1980 to a peak of more than $1.6 billion in 1988. Loan servicing activity by another California concern, United Education and Software (UES), grew astronomically in a two-year period in the mid-1980s from under $100 million to more than $1 billion. United Education and Software, in addition, was the parent company of 26 schools. UES, through FITCO, originated loans to its own students and then was responsible for servicing those same loans.

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[6] In HEAF's case, in part reflecting the dramatic increase in its guarantees of FITCO loans in the mid-1980s (from $1.4 million in 1986 to almost $300 million in 1988), the proprietary school portion of its portfolio more than doubled between 1982–1984 (from 10% to 22%) and from that time almost tripled to more than 60% by 1988. Proprietary school student loans accounted for as much as 80% of CSLFC's peak portfolio, which reached over $1.6 billion in 1988.

B. Business over education

As the volume of student loans skyrocketed in the 1980s, Subcommittee staff testified that education became "big business" in the proprietary school sector. Citing huge profits for schools and exorbitant salaries for employees and owners, the staff quoted one school president as saying that:

> There is no way to escape being a slave to the quarterly report. Quality education and higher earnings are two masters. You can't serve both.

The Subcommittee found this type of attitude to be reflected in the way many proprietary schools operated. At ACT, for example, the school's former financial aid administrator testified that contests were held whereby sales representatives earned incentive awards for enrolling the highest number of student for a given period. Likewise, receptionists with the highest number of student phone contacts were given time off and loan counselors received cash, color televisions, or other such awards for the highest number of applications processed. The former financial aid administrator "always felt a little strange that the instructors never had a contest, or that the placement office never was rewarded if they placed a high number of graduates."

The Subcommittee staff testified that most of ACT's resources were focused on enrolling students and obtaining federal funds, rather than on education. For instance, ACT employed 23 instructors, as contrasted to some 109 commissioned sales representatives and more than 70 financial aid section personnel. Moreover, the school's training and education expenses were dwarfed by advertising and sales promotion costs. In 1986, instructors salaries were 1.3% of revenues ($72,253), while advertising expenses accounted for 7% of revenues ($384,583). Two years later, while instructors salaries had increased to 1.4% of revenues ($468,079), the expenses incurred for advertising amounted to more than $11 million—an astounding 33.8% of revenues. Between 1986 and 1989, resources allocated for classroom materials declined from .4% to .3% of the school's revenues.

Another area where business dictates often overtook education was in tuition costs. ACT, as well as many other proprietary schools, routinely "front-end-loaded" tuition, i.e., charging a disproportionate amount for the early parts of programs with the expectation that many students would fail to continue through to the end. According to the National Home Study Council (the agency that accredited ACT's courses), only 50%–55% of those who enrolled in this school's courses actually completed the requisite home study portion.

The Subcommittee received testimony that proprietary schools also commonly raise tuition after having been approved to participate in Federal student financial aid programs, with little apparent justification. In the case of ACT, prior to its approval for GSLP participation in May, 1985, its tuition was $1,295. Less than five years later, the tuition had grown to $2,195. ACT's former financial aid administrator testified that she was unaware of any justification for these increases.

C. Industry profits

Driven by the profit motive, it is not surprising that many participants in the GSLP are making huge sums of money. The Subcommittee analysis of ACT provides graphic evidence of the rewards of GSLP participation. In contrast to continuous losses during its first three years of existence, in the initial year of GSLP participation, ACT went from a net operating loss of $90,926 to a net operating profit of $175,955. From that point in 1986, the school's net operating profit grew to more than $3.8 million by the end of 1988. The school owners' salaries and other benefits likewise increased dramatically—from about $218,000 in 1985 to a high of more than $4 million in 1987. Over the four-year period (1986–1989) during which ACT participated in the GSLP, its owners' salaries and other benefits totaled more than $12 million.

The vast amounts of money earned by proprietary schools during the 1980s are also reflected in the income they generate for the organizations that accredited them. The Subcommittee obtained and analyzed the financial statements of the seven major accrediting bodies for proprietary schools, i.e., ABHES, ACCET, AICS, NACCAS, NATTS, NHSC, and SACS/COEI. Each of these organizations experienced significiant income growth over the five-year period, 1985–1989. For 1985, their combined revenue was $8.5 million; by 1989, this amount had doubled to $17 million. The increase in revenues ranged from a low of 41% (221,012 to $312,208) for ABHES, to a high of 590% (283,366 to $1,954,122) for ACCET. The majority of the revenue increases are attributable to membership dues.

Lastly, the Subcommittee found that the financial players have also realized substantial volume-drive income from their GSLP involvement. In 1989, for instance, participating lenders received $2.6 billion in interest subsidies, including special allowance payments from the Department of Education. In the case of the CSLFC, in 1984 it received about $15.8 million in interest and special allowance payments on loans purchased from participating GSLP lenders; by 1987 the amount of these payments had reached about $43.8 million. Because special allowance payments are tied to the average 91-day Treasury Bill, and the interest rate increased by two percentage points between 1988 and 1989, the net amount paid to lenders in the latter year was three times higher than in the former. In effect, a one percent increase in the T-Bill interest rate equated to at least $400 million in added interest subsidy payments to lenders.

D. Problem schools

The Subcommittee received testimony that significant numbers of problem schools participate in the GSLP. Testimony confirmed the fact that even a relatively few bad schools can cause a tremendous amount of damage through fraud and abuse.

While some witnesses—e.g., representatives of an accrediting body, a guaranty agency, and a State licensing authority—downplayed the extent of problem schools, others disagreed. The Subcommittee staff cited the President of the Massachusetts Higher Education Assistance Corporation, a major guarantor of GSLP

loans, who stated recently, "I used to buy the rhetoric that there were just a few bad apples, but then I discovered there were orchards of bad apples." A South Brooklyn Legal Services consumer law specialist testified that:

> * * * there are more than a 'few bad apples'; the system is so fundamentally rotten that it simply does not—and perhaps cannot—keep up with uncovering all the bad actors.

GAO reported that about half of the approximate 2,200 proprietary schools—accredited by the seven organizations responsible for the vast majority of all such institutions participating in the GSLP—have default rates (20% or above) sufficient to require them to institute remedial actions pursuant to the Secretary of Education's Default Reduction Initiative.[7] While high default rates alone are admittedly only one measure of possible difficulties in a participating GSLP school, the Subcommittee found that they were both warning signs of potential abuse and a common thread of actual abuse in problem schools.

Even a small number of problem schools can do an enormous amount of damage in terms of overall GSLP costs. For example, according to GAO's testimony, just one school accredited by the Accrediting Bureau of Health Education Schools (ABHES) accounts for more than $5.3 million (41%) of the $12.9 million default dollars for all schools it accredits. Similarly, just 8 schools accounted for slightly more than $70 million (9.8%) of the $712.6 million in defaults generated by all 2,200 schools accredited by the seven agencies involved.

E. Students as victims

Fraud and abuse in the GSLP have had perhaps the most profound and disastrous effect on the intended beneficiaries of Federal student financial aid—the students. The Subcommittee heard testimony that unscrupulous and dishonest school operators victimize students, leaving them with huge debts and little or no education. Senator Roth expressed concern for the students:

> Rather than allowing these young people to improve themselves, these schools actually leave [them] in a worse position than when they started. Because of the deceptive practices of such schools, these students have to pay for an education they never received. Lacking proper training, [they] are not able to get jobs by which they can repay [their] federally guaranteed loans and thus suffer the added humiliation of seeing their credit ratings destroyed in the process.

One school owner cited in testimony by the Subcommittee staff bluntly stated, "I'm a businessman out to make a profit. Truly I

[7] In a study conducted at the Subcommittee's request, GAO analyzed proprietary school defaults in terms of these seven major accrediting bodies—ABHES, ACCET, AICS, NACCAS, NATTS, NHSC, SACS/COEI. GAO's study was based on Education Department data for student borrowers whose loans entered repayment in fiscal year 1988 and subsequently defaulted by the end of fiscal year 1989. According to this analysis, of more than one million borrowers in repayment at these 2,200 accredited schools, slightly more than 300,000 (28%) had defaulted on loans totalling $712.6 million.

don't care about the well being of these students." A former Education Department official testified that in his experience schools owned by such businessmen were referred to as institutions that "sold seats," and little else, to students.

In the case of the Culinary School of Washington (CSW), the Inspector General found "numerous misrepresentations" to students. Moreover, a legal services attorney who represents some of the scores of students who suffered at the hands of CSW, stated that CSW's program "was hampered by abrupt changes in teaching locations, high turnover in instructors, and a lack of quality instruction and supplies." Many students incurred about $8,000 in student loan debts only to find that their training consisted of working without pay in a cafeteria at a water treatment facility.

Practices such as these contribute to many students' decisions to withdraw, drop out, or fail to complete their programs. In instances fail to receive the training for which they contracted—a school closes (and fails to provide for a "teach-out" by another institution) and/or school employees engage in fraudulent activity, e.g., forging the student's signature on a loan check and depositing that check in the school's account—students are generally responsible for repaying their loans. Should the student eventually default, he or she is no longer eligible for Title IV student financial aid and can encounter future credit problems, tax refund seizures, and/or difficulties with collection agencies.

IV. SERIOUS PROBLEMS AT EVERY LEVEL

The Subcommittee received testimony that the huge growth in the GSLP, coupled with a virtually complete breakdown in effective regulation and oversight had opened the door for fraud, abuse, and other serious problems at every level. The Inspector General stated that audits and investigations conducted by his office in the past few years have disclosed "major fraud and abuse in these [student aid] programs, particularly at proprietary schools." The Subcommittee staff testified that at least one proprietary school President described that 1980s as "an opportune time to be crooked."

A. School practices

Unscrupulous and/or dishonest school owners and officials reaped enormous profits by evading GSLP requirements in several critical areas, including: branch campuses; refunds; admissions/recruitment; and, course length.

1. Branching

According to a recent estimate branch campuses account for about one-third of all proprietary schools.[8] The Inspector General testified that branch campuses have been systematically used to circumvent Education Department rules that require a school to be in operation for two years before participating in federal student aid programs. For example, the courses at American Masonry Institute (AMI) in Houston, Texas—brick and tile-laying—had noth-

[8] Congressional Research Service Report for Congress, *Proprietary Schools: A Description of Institutions and Students*, 90-428 EPW, August 31, 1990, based on information provided by major accrediting organizations.

ing to do with its parent's program, a barber school (Amarillo West Texas Barber Styling College) located 500 miles away from Houston. The parent school averaged 20 students with about $50,000 in student financial aid at any given point in time. In stark contrast, in less than 10 months between 1988–1989, AMI ran almost 600 students through its courses, with a cumulative loan volume exceeding $3 million. Many of these students were homeless street people—brought by bus from other major cities, including New Orleans and Dallas. The school closed owing refunds to many students who either were enrolled or had withdrawn previously.

2. Course length

GSLP funds are contingent on specified course length requirements promulgated by the Department of Education. The Subcommittee heard testimony that some proprietary schools have falsified information regarding the length of their courses and/or deliberately stretched courses beyond the level needed to train students for employment. According to the Inspector General, course-stretching can result in a proprietary school student's paying as much as 38 times the tuition charged by other postsecondary institutions, such as a local community college, for the same training.[9]

3. Admissions/recruitment

One of the most widely abused areas of those observed during the Subcommittee's investigation lies in admissions and recruitment practices. Among these practices three stand out in terms of the adverse effects they generate: false and/or misleading advertising; unethical and/or illegal recruitment efforts; and, falsification of information used to satisfy GSLP ability-to-benefit requirements.

For example, a former ACT student testified that the school's representative showed her brochures of beautiful, faraway places and said that travel agents (the program he was persuading her to enroll in) visit such spots on free "familiarization trips." After enrolling, the student discovered that travel agents pay for such trips, although at a discounted rate. The school's representative also told her that ACT had a very high placement rate, when its record in this regard was abysmal—between 10%–20% of the enrollees, according to the school's former financial aid administrator.

Likewise, a former school owner, who had been convicted of defrauding the GSLP, testified about his initial experiences in the proprietary school industry as a recruiter for a truck driver training school, the North American Training Academy.

> In the proprietary school business what you sell is "dreams," and so ninety-nine percent of the sales were made in * * * poor, black areas * * * [at] welfare offices and unemployment lines, and in housing projects * * * My approach * * * was that "if [a prospect] could breathe, scribble his name, had a drivers license, and was over 18 years of age," he was qualified for

[9] As an example, the Inspector General cites training for security guards. He points out that although few States have formal training requirements in this area—and those that do call for between 4 and 60 clock hours—it is not uncommon to find proprietary schools offering security guard courses whose length range from 300 to 700 hours.

> North American's program. My tactics * * * [which] were approved, and even encouraged, by the school's owners * * * included making the down payment for the prospect (the amount of which would be reimbursed to me out of the financial aid proceeds) and * * * going so far as to accompany the prospect to a pawn shop in order for him to obtain enough money for it.

Widespread abuse and fraud also occur in connection with so-called "ability to benefit" students. The GSLP allows students who have not completed high school or its equivalent to enroll in a post-secondary institution after having been determined by a test or counseling to have an ability to benefit from the training offered. Unfortunately, the Subcommittee heard testimony that in many instances written tests are not used, with sales representatives instead making the decision that a student has met the standards in this respect. According to the Inspector General, improperly screened ability to benefit students usually drop out, often after having incurred student loan debts they have no means to repay.

4. Refunds

By a variety of methods, unscrupulous proprietary schools abuse refund requirements, generating increased costs both to students in the amount of their debt and to the GSLP in unnecessary interest and special allowance payments.

In both case studies examined by the Subcommittee, there was ample evidence of improper refund practices. Regarding ACT, Subcommittee staff testified that the owner readily admitted that his school might have a refund liability as high as $9 million; others suggested the figure would be several times higher. ACT's former financial aid administrator testified that in both the correspondence and resident portions of the school's training program, refunds were either not made at all or were made in amounts less than the students should have received.

In the case of CSW, Subcommittee staff testified that from 1984 virtually until it closed in 1990, the school made requisite tuition refund payments either excessively late or not at all. Such problems were identified by HEAF as early as 1984 and became so serious—i.e., nearly $650,000 (more than 20%) of CSW's $3 million loan portfolio was not being refunded properly—that by mid-1986 HEAF acted to suspend the school from GSLP participation. To retain their GSLP eligibility, CSW signed an agreement with HEAF later that same year, offering to pay $550,000 of the refunds owed to former students. However, subsequent audits by the Inspector General and independent public accounting firms show that improper refunds continued to be a major problem.

B. State licensure

Testimony presented to the subcommittee established that State licensure, one of the key prerequisites for a school to participate in the GSLP, has failed to protect both the Federal government and student borrowers for a number of reasons, including: a lack of uniform standards; fragmented responsibility; inadequate staff and re-

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sources; weak enforcement authority; political considerations; and, due process constraints.

1. No uniform standards/fragmented responsibility

Under the Federal system, states are generally left with the power to set their own licensing requirements and educational standards. As a result, there is no consistent definition of the educational prerequisites that need to be satisfied in order to be licensed to operate a school.

Although the Department of Education depends on licensure as a stamp of legitimacy, there are wide disparities in the process schools undergo to obtain one. In some states the legal authorization to provide postsecondary education simply entails filing a form and paying a nominal fee for a general business license. In other states, the process involves a more thorough evaluation by boards of education or similar agencies. In still other states, a school can receive a license if it merely shows that it has been accredited.

Moreover, the responsibility for educational standards and licensing procedures can be highly fragmented within even a single state. In Georgia, as many as 45 different State agencies oversee the activities of proprietary schools. In Florida, the Department of Professional Regulation is responsible for cosmetology and barber schools, the Department of Transportation is responsible for truck driving schools, and the State Board of Independent Postsecondary Vocational, Technical, Trade, and Business Schools is responsible for schools that fall outside any other State agency's jurisdiction.

2. Inadequate staff/resources

Testimony emphasized the adverse effects of insufficient staff and resources on state licensing authorities. In Georgia, for example, between 1979 and 1989, just one individual was responsible for overseeing the activities of more than 150 such schools. Similarly, the Florida Board of Independent Postsecondary Vocational, Technical, Trade and Business Schools had only one part-time attorney to represent the state in licensing actions pertaining to the more than 500 proprietary schools it oversees.

As a result, many state licensing authorities are severely restricted in what they can effectively do in terms of carrying out their responsibilities. For example, there will simply not be enough people to go out and do cirtically important site visits or other essential tasks. Subcommittee Staff testified that both the District of Columbia and Virginia licensing authorities "were woefully undermanned" to handle the CSW case. Staff and resource shortages, moreover, often lead to otherwise unwarranted compromises that allow problem schools to continue to operate, since many states are reluctant to aggressively pursue problem schools owing to the protracted litigation this typically involves.

3. Political considerations

Given the importance of many proprietary schools in local communities, political pressure on state licensing officials—both in terms of legislative lobbying and attempts to influence actions regarding specific schools—can be enormous. In their testimony, the staff cited a licensing agency employee who told of a case where an

adverse action being considered against a school was dropped because of pressure from a state legislator.

Similar testimony was provided by the Illinois and Florida regulatory officials who appeared before the Subcommittee. The latter cited his own experience, ranging from a school owner spending $75,000 in two days to block some legislation, to an instance wherein he was offered a free Caribbean cruise in exchange for a "little help." The Illinois official testified that because of "carefully orchestrated" industry lobbying, it took more than six years to get badly needed reforms regarding proprietary schools through the State legislature.

Moreover, in many states licensing officials and legislators do not view federal student loans as their responsibility. The Illinois School Evaluation Specialist testified that:

> Perhaps one reason why many legislators are not as interested in these schools and don't pay a great deal of attention to what is going on here, is that in Illinois there is no State money involved at all. Our Scholarship Commission does not give money to students who attend proprietary institutions.

4. Due process constraints and weak enforcement

Due process constraints and weak enforcement procedures can make it extremely difficult to revoke a school's license to operate. The Illinois School Evaluation Specialist testified that during his 14-year tenure with the State Board of Education, only two schools were closed as a result of "our very cumbersome and laborious hearing process." In connection with CSW, Subcommittee staff testified that in almost every case where an adverse action was undertaken, either by the District of Columbia or Virginia, the process would be delayed for as long as a year because of maneuvering by the school's owners and/or lawyers.

The CSW case study also illustrated state problems in the enforcement area. Subcommittee staff testified that between 1984 and 1989, the District of Columbia licensing authority for proprietary schools received numerous complaints of false advertising, improper recruitment, financial misconduct, and ineffective educational practices at this school. While most of these allegations were investigated and many were confirmed, nothing seems to have been done as a result of these efforts. As one District of Columbia official put it, while the licensing agency "does good investigations. That's it, nothing ever happens."

C. Accreditation

The Subcommittee's investigation confirmed that accreditation bodies have, to date, failed to assure that proprietary schools provide the "quality of education" requisite for GSLP participation.[10]

[10] The source of the term "quality of education" is 34 CFR 602.1(a). Independent, voluntary accrediting organizations comprised of one's peers have been part of the educational landscape in the U.S. since the early 1900s. They were established to review institutional offerings and to confer recognition on schools providing quality educational programs. Originally, these organizations had nothing to do with federal student financial aid, but with the passage of the Higher Education Act of 1965 schools were required to be accredited in order for their students to qualify for the assistance available under its auspices.

Indicative in this regard is the exchange between Senator Nunn and the Executive Director of Florida's Board of Independent Postsecondary Vocational, Technical, Trade, and Business Schools:

> Senator NUNN. Mr. Ferguson, you are saying that you have more trouble in Florida with schools that are accredited than with those who are not?
> Mr. FERGUSON. Yes, sir.
> Senator NUNN. In terms of what, quality of education?
> Mr. FERGUSON. Yes, sir, I am * * *

The Florida official's comments were affirmed in subsequent testimony by both his Illinois counterpart, who noted that his officie has not received "a written complaint about any non-accredited school in the past few years," and the Secretary of Education, who said that "many accrediting agencies are not doing the job we have entrusted to them." Accreditation's poor performance reflects major problems in several areas.

1. A mismatched self-regulatory concept

Witnesses testified that the accreditation system is simply not suited to the structure and operations of proprietary schools. The accreditation approach is based almost entirely on principles and assumptions developed over the course of many years for traditional two- and four-year colleges and universities. For-profit, business considerations in proprietary school operations were neither part of this traditional approach, nor was it contemplated that they would be included.

The traditional approach assumes that those invovled are educators, whose basic concern is not profit, but the welfare of their students, and who can be counted upon to be honest and truthful in all facets of accreditation. It does not recognize certain significant differences between colleges and universities and proprietary trade schools. For example, colleges and universities do not employ commissioned sales representatives, while proprietary schools commonly use such personnel in their marketing efforts. Whereas proprietary schools are largely privately owned, many colleges and universities are publicly held. Ownership of the latter, moreover, only occasionally changes, in contrast to the fact that proprietary schools often change hands. Finally, while program, budget, and administrative activity generally occur slowly at colleges and universities, the operational environment at proprietary schools is typically fast-paced and subject to rapid change.

2. Differing expectations of accreditation's role

Significant GSLP-related problems are caused by differing expectations regarding the proper role of accreditation in connection with Federal student financial aid. The Department of Education expects accrediting agencies to assure that schools receiving GSLP and other Title IV funds are providing quality education to students. Part of that function, in the Education Department's view, involves the monitoring of such schools, once they have been accredited, to see that the educational standards are being maintained.

Accrediting agencies, on the other hand, reject the idea that it is their responsibility to see that Title IV funds are administered properly at their schools. They argue that they are not regulatory agencies and that they lack both the expertise and resources to perform policing functions in the student financial aid arena. As the NATTS Accrediting Commission Chairman bluntly put it, "while the Commission recognizes that accreditation is a prerequisite for eligibility for federal student financial aid, its role is not to enforce federal financial aid regulations."

These divergent views have far-reaching and damaging implications, as reflected in the following exchange between Chairman Nunn and a former ACCET Vice-President:

> Ms. DE VRIES. I think the most difficult area here is that the accrediting agencies do not or have not seen themselves as policemen and that the Department of Education had the concept, well, somebody is policing so certainly it must be you, because it isn't us.
>
> Senator NUNN. Everybody is looking to everybody else and nobody is doing it, right?
>
> Ms. DE VRIES. Right.

As a result, the Subcommittee staff testified that accreditation is ill-equipped to prevent GSLP fraud and abuse, as evidenced by the fact that unscrupulous, dishonest, and/or inept school owners often acquire and retain accreditation with little, if any, difficulty.

3. Inadequate policies and procedures

(a) Accreditation can be bought.—The Subcommittee's investigation confirmed that accreditation is generally transferrable in the sale of schools. Proprietary school owners routinely acquire accreditation for an unaccredited school simply by buying an already accredited one and establishing some connection, however tenuous, between the two. In Georgia, for example, an owner bought a small school in Connecticut (The Connecticut Academy), that was accredited by NATTS and ABHES. The owner then opened a branch in Atlanta, which was automatically accredited by both agencies and given a State license based upon the accreditation of the original Connecticut campus. When a Georgia Department of Education official subsequently visited the Atlanta campus she found the school to be so sub-standard that the license was cancelled.

During testimony by the Secretary of Education, Chairman Nunn raised the case of a notorious owner, whose school in California had recently lost its accreditation from ACCET and ABHES. The Subcommittee had learned that this same individual, despite the loss of his California school's accreditation, had purchased a NATTS-accredited school in Michigan, which had then been certified by the Department of Education as being eligible to participate in the GSLP.

(b) Dual accreditation/accreditation "jumping".—The Subcommittee staff testified that proprietary schools often obtain accreditation from two or more accrediting bodies, in order to ensure that Title IV funds will continue to flow if accreditation is lost from one. For example, the Culinary School of Washington was accredited by both NATTS and ACCET from July, 1985 to March, 1987.

When CSW applied for ACCET accreditation in May 1985, it had for some time been the subject of a NATTS investigation concerning allegations of fraud and misconduct. Nevertheless, ACCET accredited CSW toward the end of July, 1985; three months later, NATTS decided to withdraw the school's accreditation. With the ACCET accreditation, CSW was able to continue operations, amidst continued allegations of abuse, until its demise in 1990.[11]

(c) Branching.—Non-existent or weak accrediting agency policies have allowed schools to establish branch campuses that are automatically accredited—i.e., without being required to undergo a site visit prior to opening—as part of the institution's main campus. According to the Inspector General:

> Schools have used branch campuses to rapidly expand beyond their administrative and financial capability to properly control the programs and to fulfill their responsibilities to students. Further, because of the volume of branching activities, licensing and accrediting agencies have been unable to adequately monitor the growth and ensure the quality of education being provided by those branches.

For example, from 1985 to 1989, despite the many complaints received regarding them, none of the eight branch classrooms of the Culinary School of Washington were visited by ACCET in order to determine the quality of education being provided therein. ACCET's President testified that prior to a policy change made in May, 1990, there was no requirement for site visits to branch classrooms.

Several other accrediting bodies have recently instituted measures which, if implemented effectively, may help to curb some of the branch campus abuse. Two of the agencies, for example, will allow a free-standing institution only one branch campus application to be in process at any one time. Another agency now allows only two branch campuses for each main campus, while another permits only one in-process branch campus application for small schools and five for large, corporate institutions. While these changes are steps in the right direction, they nonetheless fall far short of the increased attention the branching problem demands.

(d) Site examinations.—Testimony presented to the Subcommittee confirmed that site visits—arguably the most important single facet of the accreditation process—often fail to identify potential and/or actual problems at schools under review. In the case of the Culinary school, for example, the ACCET site examination report painted a glowing picture of the school as of June, 1985, in sharp contrast to extremely critical reports prepared just six months earlier, pursuant to site visits by both NATTS and District of Columbia licensing authorities.

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[11] Late in 1989, the Department of Education acted to forestall accreditation jumping by prohibiting the granting of Federal student aid eligibility for 24 months to an institution that has withdrawn from accreditation, lost its accreditation, or had its accreditation suspended while it was the subject of a show-cause or other major adverse action by another accrediting body. However, neither these new rules nor accrediting agency policies specifically prohibit accreditation jumping or dual accreditation.

Site examination teams, according to several witnesses, often include individuals with insufficient training and/or experience to enable them to do their jobs effectively. The former school owner convicted of defrauding the GSLP, for instance, testified that none of the members of the NATTS site examination team that visited his barber school either had ever been to such a school or knew anything about cutting hair. He also pointed out that instead of selecting the files to be reviewed—which would reduce the possibility that the school could hide problem cases—the site team members allowed school officials to provide them.

Lastly, site examination teams can be misled and/or deceived. In one case cited by the Subcommittee staff, SACS/COEI accredited a Florida school on the basis of a site examination in which the team members had been misled unknowingly to a location other than the one they were supposed to visit. The former ACCET Vice-President testified:

> If a school deliberately wants to lie or cheat or steal, it will go to great lengths to ensure that it succeeds. The charades go beyond what I think is anticipated or expected by a reasonably knowledgeable visiting team.* * *

She recalled instances in her accreditation experience where schools had: hired actors to pose as students; prepared computer programs and hundreds of pages of supporting documents to establish false financial trails; created false records for refund checks that were never mailed to the former students; and, fabricated more than 100 student files to establish a list of "graduates."

(e) Due process constraints.—Accrediting bodies' ability to respond to problems in schools has been severely limited by due process constraints, i.e., actual and/or threatened lawsuits, recourse to bankruptcy, and mandatory review and appeals procedures in cases involving adverse actions. The Inspector General testified that:

> By securing the protection of the [bankruptcy] court, which has an interest in seeing that the schools survive through reorganization, even a school that cannot make loan refund payments to former students may continue to admit new students who in turn incur student loan obligations [even though that]* * * school may well close or otherwise cut back its educational program.

Bad schools can also thwart adverse actions against them through threatened litigation and by exploiting required review and appeals procedures. The Subcomittee staff testified that, from the time NATTS began to receive serious complaints regarding CSW in May, 1984, it took nearly three years to remove this school's accreditation. This tortuous process involved no less than three site visits by NATTS representatives, numerous requests for extensions and appeals by the school, and other delays. The NATTS Accrediting Commission Chairman testified that:

> The process was complicated because, at various points, the school made allegations that the Commission and its representatives had failed to follow proper procedures or that the process had been flawed in some respect which prejudiced the school's rights. All of these allegations re-

> quired the Commission to proceed carefully and to ensure that it did follow appropriate procedures * * * [which] necessarily slowed the process. Moreover, the Commission, at that time, was more wary of becoming embroiled in litigation.

(f) Long intervals between initial accreditation and re-accreditation.—Because accreditation is typically conferred for a span of five years, serious problems and attendant damage to students and the GSLP can go undetected for long periods. For example, in response to a question from Senator Levin regarding the NATTS-accredited Detroit Engineering Institute (DEI), NATTS' Accrediting Commission Chairman conceded that until late in 1988 his agency was unaware of serious problems that had occurred at this school between 1984 and mid-1987. The Accrediting Commission Chairman explained that DEI's accreditation had been renewed in 1982 and thus it was only when the school came up for renewal again early in 1988 that the agency's procedures surfaced these major problems.

The potential for abuse is compounded by the speed with which unscruplous school owners can move to implement their unethical and/or dishonest schemes. In the case of the Connecticut Academy, for instance, immediately upon having been accredited and licensed to operate a branch campus in Atlanta, the owner launched a highly successful tele-marketing campaign, which led to the enrollment of several hundred students within a matter of months.

4. Conflicts of interest/abuse of position

Witnesses testified that significant problems in the role of accreditation are also caused by real and/or apparent conflicts of interest.

Accreditation involves at least one inherent conflict of interest, since once a school is approved by an accrediting agency, the latter assumes the role of also acting as its advocate. The South Brooklyn Legal Services consumer law specialist testified that "accreditors clearly view themselves as the schools' advocates and not a protectors of students' or the federal government's interests." The former ACCET Vice President pointed out that accrediting agencies are supported by membership fees from the same schools they are supposed to oversee.

Moreover, the former ACCET Vice President testified that she had seen and heard of instances where school owners and employees felt compelled to provide services, donate gifts, and/or spend money in ways not required by any accreditation standard or procedure, because they believed that such actions were needed in order for them to attain or retain their accreditation. She related cases where an accreditation applicant is told he must pay a special consulting fee if his application is to be accepted for review, specifically:

> Ms. DE VRIES. * * * an accrediting official say[s], it looks like you are going to have difficulty getting through this, and in order to get through smoothly you need to have some special consultation, and I will provide that.

Senator NUNN. So the same person doing the judging is offering to provide consultation on the side?

Ms. DE VRIES. Yes.

In deciding whether to recognize an accrediting agency, the Secretary is required to determine whether the agency's:

> * * * organization, function, and procedures include effective controls against conflicts of interest and against inconsistent application of its criteria and standards.[12]

Nevertheless, as the President of the Council on Post-Secondary Accreditation testified:

> * * * despite all rules problems do arise: a team member seeks a job with the school just visited; a commission member fails to recuse and enters into discussion of a school in which he has an interest.

D. Financial players

The Subcommittee received testimony that some financial players—lenders, guarantors, loan servicers, and secondary market institutions—have exploited the GSLP for their own profit-driven ends, without regard for the students' or taxpayers' interests. The staff testified that enough financial players are:

> Taking shortcuts, misrepresenting themselves, and engaging in fraud and abuse to cheat the taxpayer out of hundreds of millions of dollars and seriously threaten the reputation and future stability of these programs.

1. Problematic business practices

Throughout the 1980s, low risks and high profits drove some financial players to handle loan volumes which far exceeded their capabilities. For example, according to FITCO's former chief accounting officer, in order to generate funds with which to make more and more loans, FITCO would routinely sell a loan to leading secondary market concerns—such as the CSLFC—within a matter of hours of the loan's origination. Indeed, in some cases, the check for the loan proceeds had not yet even cleared FITCO before the sale had been completed.

The practice of originating and selling loans at such a rapid rate caused significant problems because it did not allow time for student loan cancellations.[13] The confusion and delays generated by this practice resulted in excessive interest and special allowance payments by the Department of Education, as well as credit problems for "borrowers" who had never actually received a loan. The staff testified that FITCO was either so late in notifying guarantors and secondary market organizations about canceled loans, or altogether failed to process them, that some of these "loans" have defaulted. The Department of Education paid guaranty agency claims on such loans, even though they were never accepted by a student.

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[12] 34 CFR 602.16(g).

[13] According to GAO'S testimony, preliminary analysis shows that in contrast to the national average for cancellations (about 13%), the California Student Aid Commission and HEAF, respectively, experienced 28% and 37% cancellation rates for their FITCO loans.

The profit motive also drove guaranty agencies, such as HEAF, and secondary market concerns, such as the CSLFC, to maintain excessive numbers of proprietary school loans in their portfolios, despite significantly higher default rates for proprietary schools.[14] Both HEAF and CSLFC respectively guaranteed and bought hundreds of millions of dollars of FITCO loans, which consisted almost entirely of those from proprietary schools.

The effects of this emphasis on proprietary school loans has been staggering. The Bank of America's representative testified that as a result of the $547 million in FITCO proprietary school loans guaranteed by HEAF, taxpayers are facing possible losses between $200 and $400 million.[15] Moreover, HEAF's ultimate downfall is, to some significant degree, attributable to problems with proprietary school loans. According to HEAF's President, nearly half of his agency's proprietary school loans were defaulting at the time of his appearance before the Subcommittee.[16] Moreover, the Subcommittee staff testified that problems similar to HEAF's have already begun to surface at other guaranty agencies.

As profit and financial considerations mushroomed in the 1980s, lenders and other financial players became more and more removed from any direct interaction with the students. They were, as a result, often indifferent to the students' interests and needs, as suggested by the the former Education Department official who testified that during the 1980s student loans:

> * * * became a mail order business. The school filled out an application * * * sent it to some bank [and] the student had no idea * * * whether [the loan] came * * * from California or otherwise.* * *"

2. Pattern of abuse/ineffective oversight

The testimony presented to the Subcommittee established repeated abuse of GSLP rules and regulations by many financial players, as well as a failure on the part of state and federal authorities to detect and/or take action regarding these irregularities. For example, witnesses testified that FITCO failed to file required quarterly interest and special allowance reports, made refunds excessively late and/or not at all, and failed to pay required loan origination and guarantee fees for a number of years. These ongoing problems, according to a HEAF review conducted just before the California Banking Department finally shut FITCO down, were "of such seriousness and magnitude" that substantial losses to borrowers, guarantors, and the Federal government were inevitable.

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[14] During the 1980s proprietary school loans defaulted at a rate that at one point was nearly five times that of traditional two-and four-year post-secondary institutions.

[15] These potential losses could be much higher if future defaults among the remainder of FITCO's overall $1.5 billion student loan portfolio occur at the 70–75% rate cited by HEAF'S President in reference to his agency's recent projections.

[16] HEAF'S serious financial problems and ultimate demise sent shockwaves throughout the student loan community and beyond, since a failure on its part to meet its obligations could have caused lenders to lose faith in the other GSLP guaranty agencies and stop making student loans. A possible crisis along these lines was averted only after the Department of Education intervened, reaching an agreement with the Student Loan Marketing Association (Sallie Mae), the nation's largest holder of student loans, to take over and parcel out HEAF'S portfolio among other guaranty agencies.

The staff testified that between 1975–1988, California and federal authorities conducted 20 reviews of FITCO's operations, several among them being "quite damning." Despite that fact, FITCO was able to gain approval as a participating GSLP lender in 1980 and remain such until its demise in 1989. Winding up their remarks on this point, the staff stated that:

> While we are critical of the [state] banking department for allowing FITCO to continue to operate, we are also critical of the federal system for relying so heavily on state regulators as a precondition for participation in [the GSLP].* * *[17]

It is important to note that the lack of appropriate Congressional oversight played a key role in allowing FITCO to continue its reckless practices for so long. In the 1986 Reauthorization of Higher Education Act, for instance, a special provision applicable, in effect, only to FITCO was added, which allowed it to be exempt from the requirement that student loans constitute no more than 50% of a participating GSLP lender's overall loan portfolio. This special concession allowed FITCO to increase the volume of its risky loans and continue its questionable behavior.

Evidence of widespread abuse of GSLP rules and inadequate regulatory oversight also surfaced in the Subcommittee's investigation of "due-diligence" requirements.[18] According to a February, 1990 Inspector General report, many participating GSLP lenders have been cited for serious and continuing due-diligence violations. The Inspector General reported that of the borrower files reviewed at 101 GSLP lenders, "87% contained due-diligence exceptions."

The extent of due-diligence abuses was underscored by the Subcommittee's case study of United Education and Software (UES), the servicer that handled loans originated by FITCO and other lenders, which were subsequently purchased by the CSLFC. UES' loan servicing business grew from zero to $600 million between 1983–1987, and over the next year, jumped to more than $1 billion. However, as the size and number of portfolios it serviced grew, UES became less and less able to perform its required functions. As summarized in staff testimony:

> What had started out * * * as a "mom and pop operation," became in a short period of time one of the larger servicers in the country. Unfortunately, it did so without the benefit of an adequately sized * * * [or] trained staff, without the benefit of adequate computer and other support systems, and without the benefit of adequate internal controls and procedures.

As a result, a wide range of due-diligence-related short-cuts, falsifications, and other serious abuses occurred at UES. In the course of a June, 1988 review by staff of HEAF and the Inspector General's office, hundreds of boxes containing thousands of pieces of un-

[17] The U.S. Department of Education's failed role in this regard is discussed separately below.

[18] Due-diligence requirements consist of a complex and detailed series of actions that lenders, loan servicers, and others in the financial chain are supposed to follow in trying to keep track of and collect on delinquent and/or defaulted loans. If due diligence requirements are not met, the federal loan guarantee can be lost.

opened returned mail were found in the UES warehouse. In other boxes, the review team found thousands of unprocessed requests by former students for deferments and forbearance, two effective tools for preventing defaults. HEAF's President and the Subcommittee staff also testified that UES falsified records of due-diligence-mandated telephone calls. Employees, for example, were instructed to allow the phone to ring only two times and then list the call as a "no answer." At other times, employees were told to insert "call/no answer" entries into the computer without even making the calls. According to HEAF's President, "such collection records, were knowingly used as the basis for insurance claims submitted to guarantors who, in good faith, submitted them to the federal government for reinsurance."

Lastly, according to the Subcommittee staff, the pressure to meet deadlines led to several forms of claims package doctoring. For instance, employees were instructed to send claims packages to the guaranty agency, despite missing documentation. Employees were also told to backdate claims packets so that it would appear that they had been sent out within the appropriate timeframe.

Despite these problems, auditors retained by the CSLFC reviewed UES' operations annually and disclosed nothing to indicate that its servicing system and procedures were not in accord with due diligence regulations. Former UES employees said that the firm generally knew in advance which student files were to be reviewed and that, before the audit, those files were updated by correcting, and/or falsifying the information contained in them.

It was not until a series of reviews by HEAF in April and June, 1988 and a later joint audit by the U.S. Department of Education, the California Student Aid Commission, and HEAF in August, 1988, that UES' overall ability to perform was seriously questioned. As summarized in the latter:

> UES has demonstrated no ability whatsoever to service loans in accordance with Federal regulations. UES' performance has caused unmeasurable hardship to hundreds of thousands of borrowers and has cost guarantors, the United States Government, and taxpayers millions of dollars.

V. THE ROLE OF THE U.S. DEPARTMENT OF EDUCATION: A DISMAL RECORD

The Subcommittee's investigation revealed that the Department of Education has failed to efficiently or effectively carry out its GSLP responsibilities. Virtually every witness described instances of gross mismanagement, ineptitude, and/or neglect in the Department's performance of its GSLP-related regulatory and oversight functions. As noted by Chairman Nunn in his opening remarks on the last day of the Subcommittee's hearings:

> It is not an exaggeration to say that we have heard no testimony or seen any documents that suggest that the Department has done even an adequate job in managing and overseeing its student loan program responsibilities. Moreover, criticism of the Department's efforts in this area is not unique to this investigation: in 1975 this same Subcom-

> mittee heard testimony on student loan program problems that is disturbingly similar * * * to that which we have heard in these hearings. GAO, over a period of many years, has also repeatedly brought many of these problems to the Department's attention. Despite all of that, the program's failures seem only to have gotten worse.* * *

Specifically, the Subcommittee's investigation found pervasive and persistent problems in at least five areas of the Department's GSLP operations, including:

A. Eligibility and certification

Testimony established that the Department's eligibility procedure amounts to little more than a paperwork review of information submitted by the school. Eligibility is based on determinations made by accrediting agencies and state licensing authorities, bodies outside the Department whose standards and criteria vary widely in their quality and quantity. The Department has rarely revoked eligibility for reasons other than the loss of a license or accreditation.

Moreover, the Department has failed to take adequate corrective action in instances where it erroneously approved an institution that lacked the required accreditation or license. The Inspector General cited one case where the Department's failure to revoke eligibility or to notify those responsible for cutting off the flow of funds resulted in the receipt of about $480,000 in student financial aid by three ineligible institutions.

Other significant deficiencies in the eligibility area include the Department's failure to comply with regulations that require each institution to have its eligibility updated at least every four years. As of December, 1989, 4,555 schools were overdue for this redetermination and none had ever been terminated for not responding to an update request. Finally, the Inspector General testified that the Department did not have a complete list of eligible institutions and that important eligibility information was unavailable because files had been lost or misplaced.

The Department's handling of certification—i.e., the determination of an institution's financial and administrative capabilities—has also failed to adequately protect either the students' or the government's interests. The Inspector General testified that of the 2,087 institutions reviewed by the Certification Branch between October, 1985 and September, 1988, 2,024 (97%) were certified.[19] Nevertheless, as of October, 1988, about 800 (38%) certified institutions were financially troubled and/or had administrative deficiencies. During this same timeframe about 150 certified institutions closed, more than one-third of which did so so abruptly that all educational services were not provided to the students.

The Department's certification review is limited in scope and significant information is either not used or is used without being verified. For example, ACT was certified, in part, on the basis of a statement of revenue and retained earnings that showed the school to have had a net operating profit of more than $150,000 for 1984.

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[19] The Department testified that currently 10–12% of applications for certification are denied.

However, in the Subcommittee's review of ACT's subpoenaed financial records, another public accounting firm had prepared financial statements that showed the school as having had a net loss of more than $20,000 for the same year.

In addition, institutions are certified even when there were clear indications of significant administrative deficiencies; e.g., withdrawal rates exceeding 33% and, in some cases, 50%.[20] Moreover, in the case of surety arrangements, whereby financially weak schools are certified on the basis of posting cash, bonds, or other assets as a guarantee against any potential loss, many were plainly inadequate. In one case, a severely troubled school, whose recertification was based on increasing its surety bond from $20,000 to $100,000, declared bankruptcy leaving students with loans worth more than $700,000 and the Department with about $1 million in cash advances. The Department failed to collect the $100,000 bond and was unable to go after the cash advances because the school had no assets.

B. Accrediting agency recognition

The Department depends on independent accrediting agencies to assure the quality of education in institutions that participate in the GSLP and other student financial aid programs. The Department does exercise some limited control over quality of education through its recognition of certain accrediting bodies for GSLP purposes. The Secretary of Education appoints a 15-member group of volunteers, the National Advisory Committee on Accreditation and Institutional Eligibility (NAC) which, supported by the Department's Accrediting Agency Evaluation Branch (AAEB), reviews the accrediting agencies' qualifications and makes recommendations to the Secretary, who makes the final decision regarding recognition.

Testimony before the Subcommittee was extremely critical of the performance of both the NAC and AAEB. According to the testimony of a former member who served on the NAC from 1980–1983, as many as two-thirds of the appointees that participated during her tenure were neither knowledgeable about nor interested in the accreditation issues for which they were responsible. She testified that, one member kept asking at each NAC meeting, "can someone tell me again what it is we are supposed to be doing here?" This same member was reappointed for more than one term.

The former member also testified that the training for NAC members was completely inadequate and that the NAC workload needed more than the prescribed two meetings per year to address. The Inspector General testified that NAC:

> * * * members were not always sure about the options available to them when considering whether an accrediting agency met all the recognition criteria, and NAC did not always make consistent decisions. * * *

[20] In such circumstances, the Department placed the institution on a monitoring list, which merely meant that it was required to annually report on the status of its excessive withdrawal rate and measures being taken to correct it. Moreover, even if the school failed to correct or improve on this situation, its certification was not subject to revocation as a matter of policy.

Regarding the AAEB's performance, testimony revealed even more extensive and significant problems. The staff testified that the AAEB focuses on whether the agency documentation on its face meets the Department's requirements and does little verification of the information provided.

Moreover, even where negative information is uncovered, the AAEB has failed to use it effectively. For instance, according to the Subcommittee staff, in reviewing the continued recognition of the troubled Accrediting Commission for Continuing Education and Training (ACCET), the AAEB staff failed to:

(1) Inform the NAC about serious deficiencies that affected ACCET's ability to perform its functions effectively;

(2) pass on valid third-party complaints, which indicated that ACCET was accrediting schools that were clearly not providing a quality education for their students; and,

(3) provide sufficient notification to third-party sources to ensure them of a full opportunity to present their views at the public hearings segment of the recognition process.

In the absence of such critical information, the NAC followed the AAEB's recommendation to continue ACCET's recognition. Moreover, witnesses testified that during the ten-year period prior to the Subcommittee's hearings, no agency was removed from the Secretary's list of recognized accrediting bodies.

The AAEB staff maintain that federal regulations do not allow them to hold accrediting agencies accountable for their schools' compliance with Title IV requirements. The Inspector General and the Deputy Assistant Secretary of Education for Higher Education Programs testified that the Department's regulations and criteria are vague on this point and do not explicitly require accrediting agencies to be responsible for Title IV compliance issues.

This "lack of authority" defense was cited by Education Department officials at other times during the hearings. For example, the following exchange between Chairman Nunn and the Inspector General is instructive:

> Senator NUNN. * * * you say that, "ED management advised us that they did not have the authority to take strong actions, such as termination, when schools did not sufficiently correct high withdrawal rates." Do you agree with the Department's position on that?
>
> Mr. THOMAS. We agree that it is not clear in the regs and we think the regs ought to provide for that kind of thing.
>
> Senator NUNN. But who is responsible for the regs?
>
> Mr. THOMAS. We in the Department are.
>
> Senator NUNN. So the same people who are saying they don't have the authority are the ones responsible for initiating the regs themselves, aren't they?
>
> Mr. THOMAS. I would say so, yes, sir. * * *

In sum, testimony revealed that the Department cannot assure either the reliability of the accrediting agency recognition process or its own ability to take effective action when deficiencies in these agencies' performance are identified. Despite that fact, the Depart-

ment continues to rely on accreditation as one of the key bases on which eligibility to participate in the GSLP rests.

C. Financial players regulation/oversight

The Subcommittee's examination of the collapse of FITCO revealed that the Department "fell miserably short" [21] in its responsibilities to the GSLP's financial players. In the FITCO case, the testimony described a pattern of mismanagement and ineffective administration by the Department, including, but by no means limited to, the failure to: perform essential tasks; enforce key rules and regulations; and, act quickly and/or decisively in response to known problems.

For example, regarding loans made by FITCO from 1984 through 1989, the Department failed to collect millions of dollars in origination fees owed the government, as well as the required quarterly reporting forms.[22] The former Education Department Region IX official testified that the Department simply did not have any program to monitor such non-compliance. According to guaranty agency and Departmental records, FITCO on some occasions failed to file reporting forms entirely, or filed them literally years after they were due.

While the Department knew as early as 1984 that FITCO needed to pay loan origination fees, it did not aggressively attempt to collect those amounts until 1988, when the problem was cited by a guaranty agency. While estimates of the amount of uncollected origination fees vary, the loss to the taxpayer has already exceeded one million dollars.

Testimony also described significant deficiencies in the Department's lender and guaranty agency reviews. In the case of FITCO, for instance, the Department conducted only four reviews between 1981–1989. From 1984–1988, at the time when GSLP growth exploded and major problems began to surface, Department lender reviews declined from 763 to 282 (63%). The former Education Department Region IX official described the Department's reviews of FITCO and others as a "paper drill" and a "cursory thing," which ignored the financial condition of an institution. At one point in the mid-1980s, the official testified that he had no travel funds and a staff of just three program officers to cover 800 lenders located throughout California, Arizona, Nevada, Hawaii, and the Trust Territories.

Testimony also questioned the wisdom of some Departmental policies and procedures relating to GSLP financial players. For example, guaranty agencies are now permitted to defer initial loan collection efforts, recover the cost of the loan from the government, and then allow the loan to default, in hopes that they might recover an additional 30% to 35% of the loan's value in subsequent collection actions.[23] The Inspector General testified that the Depart-

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[21] According to Subcommittee staff testimony.

[22] Lenders of Stafford Student Loans collect a 5% origination fee from borrowers. These fees are paid to the Department of Education to help offset the cost of the Department's interest and special allowance payments to lenders. The Department typically collects these fees from lenders by subtracting them from their quarterly interest subsidy payments.

[23] 20 U.S.C. 1078(c)(6)(A)(ii) allows guaranty agencies to retain up to 35 percent of the amount collected on previously defaulted loans. There is no statutory requirement that guaranty agen-

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ment's present procedures constitute a "disincentive for aggressive default prevention" and, as such, "does appear to be a weakness of the current guarantee agency structure."

Witnesses also criticized the Department's tolerance of what its General Counsel referred to as "the arbitrage game," whereby guaranty agencies avoid penalties for excessively high default rates by delaying submission of defaulted loan claims to the government. In effect, guaranty agencies are free to hold claims indefinitely, which allows them to take advantage of the Department's policy of cleaning the slate at the end of the prior fiscal year. As a result, a guaranty agency can be reimbursed for 100% of its loans, instead of the 90% or 80% it would have received if it had not been allowed to delay in submitting its claims. Guarantors are able to meet short term cash-flow problems by delaying payments to lenders and/or by obtaining short-term balloon loans from other financial entities such as the Student Loan Marketing Association (Sallie Mae). Department officials admitted that HEAF had been permitted to avoid penalties for high defaults prior to its ultimate demise in 1990:

> Senator NUNN. So the [Department's] 80 percent reimbursement [requirement] was a farce, anyway?
>
> Mr. STRINGER. It became a farce.
>
> * * * * *
>
> Senator NUNN. The bottom line, though, is that the taxpayers are now going to reimburse these HEAF loans on a 100 percent basis.
>
> Mr. STRINGER. That's correct.

The Department's lack of oversight of guaranty agencies was apparent in the aftermath of the HEAF failure. The Department had failed to foresee such a failure and was forced into crisis management to resolve the issue. The solution entailed a Department/Sallie Mae contract creating a Sallie Mae subsidiary to distribute the $9 billion HEAF portfolio to other guarantors. This distribution will most likely result in the taxpayer absorbing the full cost of the defaulted loans in that portfolio. Further, the HEAF failure resulted in the need for new guarantors or management arrangements with existing guarantors, to fill the void in the states in which HEAF was the designated agency. The ultimate cost to the taxpayer is yet to be calculated.

Finally, despite the importance of secondary market organizations and loan servicers in the GSLP, the Department does not regulate or monitor their GSLP-related activities in any comprehensive or systematic way. According to a February, 1990 report by the Inspector General, the Department did not know, for example, how many secondary markets there were or whether anyone was evaluating their performance. The Inspector General testified that by failing to monitor the activities of loan servicers, the Department risks: payment of inaccurate interest and special allowance bil-

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cies submit loans to the Department for reinsurance or for collection by the Executive Branch, but the Secretary has the authority to recall defaulted loans for collection by the government (20 U.S.C. 1078 (c)(8)).

lings; reduced collectibility of loans; reinsurance payments for ineligible claims; and, harm to borrowers' credit ratings.

The Department maintains that it does not have the authority to perform such oversight and/or regulation, despite the fact that in the FITCO case alone hundreds of millions of dollars in potential losses were inextricably tied to the performance of the loan servicers (UES) that handled FITCO's secondary market organization (CSLFC).

D. Administration/management

The Subcommittee received extensive testimony that described repeated mismanagement and ineptitude at every level in the Department's execution of its GSLP responsibilities. The Secretary of Education himself admitted serious problems in the program existed, citing "inadequate legislative authority for the Secretary to establish meaningful program controls and to eliminate wrongdoers; inadequate Federal oversight for many years, and inadequate performance by accrediting agencies, guarantors, schools and lenders." He concluded, "there is plenty of blame for everyone."

Congress, too, must share some of the blame for failing to provide the Department with all of the tools it has needed to oversee the program. Congress, for instance, was reluctant to tighten GSLP ability to benefit requirements, notwithstanding the Department's repeated requests for this change since the early 1980s. Further, Congress has yet to agree on a comprehensive default reduction strategy, which would strengthen the Department's ability to eliminate bad actors from the program.

However, even when Congress did act, the Department often failed to expeditiously implement important legislative initiatives. Senator Kennedy, for example, criticized Department delays "well beyond the point of reasonableness" in implementing regulations mandated by major legislation. The Secretary of Education acknowledged this problem, conceding, that a notice of proposed rulemaking to implement regulations mandated by the 1986 Higher Education Act reauthorization was finally published on November 20, 1990. The Secretary testified that he was:

> * * * as frustrated as you are that it takes that long. I can't believe how long some of those regulations take * * * and I'm not sure that we have an answer.

Several witnesses described major and long-lived deficiencies in the Department's student aid data systems. As cited in the Subcommittee staff statement, for example, the General Accounting Office reported that they were unable to audit the guaranteed student loan insurance fund because of the "poor condition of the financial records at the Department." A representative of the Consumer Banking Association testified that the Department was operating on "1970s computer technology," and recommended hiring three computer systems experts to totally revamp the information management system. A March, 1987 Inspector General report found the Department's Institutional Data System (IDS) to be neither complete nor accurate. The Secretary himself admitted that, "we are in trouble, frankly, in terms of our data systems, and we are trying to get those up to speed." The Director of Debt Collec-

tion and Management Assistance Service testified that efforts to establish a guaranteed student loan database had been going on throughout his 15-year tenure at the Department, with little apparent success.

The Department's performance of its GSLP regulatory and oversight functions is also replete with instances of poor and/or nonexistent coordination/communication, both internally and externally.[24] For example, the Department has failed to systematically coordinate and/or communicate with the Department of Veterans Affairs (VA), which has its own student aid program. The VA's program parallels the GSLP in many respects and involves many of the same institutions. Yet, because the Department and VA do not coordinate adequately, when one agency takes some kind of adverse action against a jointly participating school, the other is generally unaware of this situation.

The Subcommittee also learned that communication among the Department's various regional offices is so poor that a school operating in one region can open a branch in another region without the latter ever knowing it. Department employees complained to Subcommittee staff in 1990 that headquarters personnel in Washington had refused to send copies of guaranty agency program reviews to the Department's regional offices. Department officials admitted that delays in forwarding reports had occurred in the past, but claimed that the problem had been corrected.

Witnesses testified that even within the Department's headquarters in Washington difficulties in communication exist. The staff's investigation found a lack of adequate coordination/communication between the Department's program review and certification offices, which are located in the same building. For example, the Department's Division of Eligibility and Certification is not under the purview of the Deputy Assistant Secretary for Student Financial Assistance, the office which includes the regional program review, audit, and compliance elements. Moreover, files on GSLP participating schools are maintained in a variety of separate Departmental offices, with no master file or cross index available.

E. Enforcement

The Subcommittee investigation also uncovered major shortcomings in the Department's enforcement capabilities, especially in terms of resources, expertise, and initiative by Department personnel. For example, in the Culinary School (CSW) case, serious problems were identified as early as a Departmental review in January 1983—just a matter of months after the school had been approved for GSLP participation. Subsequent reviews by the Inspector General, HEAF, and the VA, showed that these initial problems were not isolated and, indeed, were continuing and growing worse. The VA went so far as to force CSW's "voluntary withdrawal" from its student loan program in April, 1986. Even though the Department was aware of the VA's action and the adverse findings in the

[24] In addition to the Department's problems, coordination and communication gaps are a widespread and pervasive problem throughout the student financial aid community. Witnesses testified that state licensing authorities, accrediting agencies and participating financial institutions fail to share and/or coordinate, among other things, basic data, information regarding adverse actions, and standards and procedures.

HEAF and Inspector General's reviews, it allowed CSW to remain in the GSLP and admit students and process loans right up until District of Columbia licensing authorities forced it to close in 1990.

Moreover, Department officials stated that even if the Department had been aware of published reports that the owner of CSW had previously embezzled over $100,000 from Southeastern University, the Department would probably not have acted, since investigations are "limited to possible misuses of *Federal* funds." [25]

The Department maintains that its enforcement ability in such cases is impeded by existing due process requirements. The Inspector General testified that legal obstacles, such as "a hearing on the record," can often delay prompt punitive action on the part of the Department since they are costly and can take months to complete.

The Department's enforcement efforts are also undercut by inadequate inspection procedures and insufficient program compliance support. The Subcommittee staff testified that in connection with program reviews, for example, Departmental reviewers are particularly susceptible to manipulation because they provide the school being examined with a listing of the student files to be reviewed and then allow the school's employees to provide these files. This enables schools to alter these records before the reviewer gets to see them.

The Subcommittee's investigation of ACT revealed that in an October 1988 program review by Departmental regional office staff, the reviewer admitted that she did not hand-pick the student files reviewed. As a result, according to the testimony of ACT's former financial aid administrator, information was manipulated in some of the files requested. Reflecting still other defects in the Department's investigation procedures, this same reviewer admitted that she did not: interview students or faculty; report inadequacies she found in the academic environment; and, report her suspicions regarding the school's extreme increase in enrollments and the percentage of student's receiving federal loans.

In addition, even when a program review uncovers violations of Departmental regulations, Subcommittee staff testified that schools may only be held accountable for the actual findings of that specific review. Department personnel told the staff that usually no follow-up is done to determine whether additional violations exist. For example, if 50% of the files reviewed indicated that refunds were not being made to students who had withdrawn, the school would normally be asked to make refunds only on those files reviewed.

In the area of program compliance support, the Department's review staff do not generally have any criminal investigative background or training and are not necessarily knowledgeable about financial auditing. As a result, program review employees often do not recognize potential fraud or other criminal misconduct when they conduct school, lender, or loan servicing reviews. Reflecting this deficiency, compliance staff have relied heavily on Office of In-

[25] The CSW case is not an isolated instance of the Department's failing in this regard. For example, the South Brooklyn Legal Services consumer law specialist testified that the principal owner of the Adelphi school chain, just months before having been licensed by New York State, accredited by AICS, and certified by the Department to participate in the GSLP, had been convicted of defrauding the federal government of manpower training program funds.

spector General auditors and criminal investigators to detect and pursue such cases.

VI. FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The Subcommittee's investigation of the federal guaranteed student loan program found a well-intentioned program that has deviated seriously from its intended purpose and stated goals. Plagued by fraud and abuse at every level and lacking meaningful oversight and management controls, the program has become inefficient, ineffective, and far too costly.

Unquestionably, the guaranteed student loan program has vastly expanded accessibility to education for those Americans who seek it. The value of accessibility, however, depends on what it is that one is being given access to. On that point, the Subcommittee found that the program has failed, particularly in the area of proprietary schools, to insure that federal dollars are providing quality, and not merely quantity, in education.

As a result, many of the program's intended beneficiares—hundreds of thousands of young people, many of whom come from backgrounds with already limited opportunities—have suffered further because of their involvement with the GSLP. Victimized by unscrupulous profiteers and their fraudulent schools, students have received neither the training nor the skills they hoped to acquire and, instead, have been left burdened with debts they cannot repay.

Likewise, the American taxpayer has suffered, both in terms of footing the bill for billions of dollars of losses in defaulted loans and the ultimate cost of the program's failure to provide the skilled labor force our Nation needs in the increasingly competitive global marketplace. Conversely, while students and taxpayers have paid dearly, unscrupulous school owners, accrediting bodies, lenders, loan servicers, guaranty agencies, and secondary market organizations have profited handsomely, and in some cases, unconscionably.

The testimony presented and the voluminous record examined by the Subcommittee revealed an overwhelming number of problems and a proliferation of abuse in the operation of the GSLP. For example, the Subcommittee found that the mechanism on which GSLP oversight of schools depends—the Triad of licensure, accreditation, and certification/eligibility—provides little or no assurance that schools are educating students efficiently and effectively. Similarly, the investigation disclosed that the lure of fast and easy program profits, coupled with no effective government oversight, had already had devastating effects on the program's financial intermediaries, with similar problems likely in the future. Lastly, the Subcommittee found that through gross mismanagement, ineptitude, and neglect in carrying out its regulatory and oversight functions, the Department of Education had all but abdicated its responsibility to the students it is supposed to service and the taxpayers whose interests it is charged with protecting.

In sum, in its present state, the GSLP's credibility has been severely eroded and the program is faced with the prospect of drastic action that could significantly reduce its size or even result in its being eliminated entirely. In order for the GSLP to survive its cur-

rent difficulties, it is the Subcommittee's view that nothing less than a comprehensive, intensive, and sustained effort to reform the program is needed. In this regard, the Subcommittee acknowledges that the Congress and the Department have recently instituted a number of important measures, including: a Default Reduction Initiative designed to reduce student loan defaults, by, among other things, targeting the worst offenders and delaying disbursement of SLS loans; emergency action regulations, which authorize the Secretary to immediately suspend schools responsible for major abuse of the Department's student aid programs; and, other actions, such as eliminating the bankruptcy recourse used by schools trying to escape adverse action by accreditation agencies, independent ability-to-benefit testing, focusing on high default schools and the agencies that accredit them, and finalizing the development of the National Student Loan Data System.[26]

Notwithstanding these efforts, a great deal remains to be done to restore the GSLP's integrity and return its focus to serving the interests of the students. With this in mind, the Subcommittee offers the following recommendations:

(1) Congress and the President should, as part of the reauthorization of the Higher Education Act in the 102nd Congress, undertake major and, in some areas, drastic reform of the guaranteed student loan program. Nothing less than a comprehensive, intensive, and sustained effort is needed to refocus the program on its intended purpose—accessibility and quality in education and training for American students. Congress and the President must act decisively and immediately to curb waste, fraud and abuse in the GSLP or face the ultimate collapse of the program.

(2) Congress and the Administration must hold the U.S. Department of Education accountable for the regulation and oversight of the GSLP. In the past, the Department has effectively abdicated its GSLP oversight responsibilities to private accrediting bodies, State licensing authorities, and guaranty agencies. Experience has proven that those bodies have neither the motivation nor the capabilities to effectively police the program.

(3) Prior to the commitment of federal funds for student aid, the Department of Education must require strict and credible assurance that recipient institutions provide the students with a quality education. The accrediting bodies recognized by the Secretary of Education, especially in the area of proprietary schools, have to date failed to provide that assurance. Either those bodies, under the leadership of the Department, must dramatically improve their ability to screen out substandard schools, or the government should cease to rely on them in authorizing a school's participation in federal student aid programs.

(4) The Department of Education should be required to develop minimum uniform quality assurance standards, with which all recognized accrediting bodies that accredit proprietary schools must comply. The Department should be responsible not only for formulating those standards, but also for developing and carrying out a

[26] Some of the measures cited—e.g., the 1989 Default Reduction Initiative—were instituted before the Subcommittee's investigation began. The remainder occurred during or, as part of the Student Loan Default Prevention Initiative Act of 1990, immediately following the investigation.

meaningful review and verification process designed to enforce compliance with those standards. If the Secretary determines that an accrediting body does not or cannot meet these requirements, recognition should be terminated.

(5) The Secretary of Education, through the Department's accreditation recognition process, should require accrediting agencies to: improve their site examination procedures by doing them at shorter intervals, providing for unannounced visits, and increasing the training of team members; share information with one another regarding all adverse actions against schools and school owners; publicly disclose when schools are coming up for accreditation and/or reaccreditation; and, develop and make public uniform performance-based consumer protection standards, including, but not limited to, criteria on enrollments, withdrawal rates, completion rates, placement rates, and default rates.

(6) Congress should consider the feasibility of setting reasonable limits on the type of proprietary school education that federal dollars should subsidize, emphasizing education and training from which students, and ultimately, society as a whole, will realistically benefit. In the past federal financing for relatively worthless training in "glutted" career fields has created unnecessary financial costs to the taxpayer and very real costs to the students in terms of lost opportunities in marketable skills. As a start, the Department of Education, along with the Department of Labor and industry, should develop and make widely available accurate information on current and future market needs for those trades and skills that are subsidized through federal student aid programs.

(7) Congress should specify that proprietary school correspondence courses should no longer be eligible to participate in federal student financial aid programs. Education by correspondence can be a valuable method of instruction for those who are self motivated. However, the Subcommittee received overwhelming evidence that extensive abuse has occurred in these programs and that effective regulation of correspondence courses has proved nearly impossible. On balance, when considering correspondence courses and federal student aid programs, the risk of inclusion far outweighs the potential gain.

(8) The Department of Education should revise limits on the amount of federal student financial aid for proprietary schools, to better reflect the cost of equivalent training available through other legitimate sources of postsecondary education. The Subcommittee received testimony that schools often receive federal funds for inflated and exorbitant tuition costs, when the same, and oftentimes better, education and training is available elsewhere at a fraction of the cost.

(9) Through their licensing and consumer protection organs, States must vastly improve their efforts to assure that only quality education is offered to their citizens through schools and businesses operating within their boundaries. In their licensing role, the States directly impact the effectiveness of the GSLP, given the Department of Education's heavy reliance on them as a requirement for GSLP participation. The Department of Education should, therefore, assist the states by recommending uniform minimum licensing requirements, covering areas such as: recruitment; adver-

tising; admissions; separation of admissions from financial aid; site visits; complaint procedures; completion and placement data; and, enforcement procedures. As an incentive for the states to adhere to these standards, the Department of Education should refuse to recognize, for purposes of GSLP participation, schools operating in states that do not adopt these minimum standards.

(10) The Department of Education should initiate a complete overhaul of its management of the GSLP, with special emphasis being placed on the Office of Postsecondary Education. This effort should include, at the minimum: the appointment of an Assistant Secretary for Student Financial Assistance, accountable for all aspects of the student aid programs; a complete overhaul of the certification and eligibility award and program review processes; the establishment of an office of oversight and enforcement to aggressively oversee activities of all program participants; and, the creation of streamlined and modernized informational systems, stressing improved communication and data exchange both within the Department and between the Department and program participants.

(11) To the greatest extent possible, the Department of Education should standardize its interpretation and enforcement of legislation and regulations. During the course of the Subcommittee's investigation, numerous program participants complained of overly complex regulations and administrative procedures, and of receiving widely varying interpretations regarding them from Departmental headquarters and regional office employees.

(12) When abuse and/or fraud are found, the Department of Education, states, accrediting agencies, and other GSLP participants with oversight responsibility must act swiftly and decisively to cut program losses and take appropriate corrective and/or punitive actions. The Subcommittee found that inaction, delays and unnecessary procedural hurdles have halted effective action in the past. The Department should review and streamline current hearing and procedural requirements, eliminating unnecessary delays while guaranteeing basic due process protections. As a part of that review, the Department should address and report to Congress on the question of whether accrediting agency officials involved in the performance of their legitimate GSLP responsibilities should be subject to reasonable liability limits and/or be statutorily protected from lawsuits.

(13) Instead of merely relying on the already overburdened Office of the Inspector General, the Department of Education's program compliance staff must assume a far greater and more proactive role in detecting and dealing with fraud, waste, and abuse. As a start, the Department must recognize the propensity for criminal fraud and abuse in the GSLP and require criminal investigative training and expertise for its program compliance staff. Credible inspection and follow-up procedures must be instituted in program reviews of schools. Banking and financial auditing specialists should be hired by the Department to assist the staff in carrying out oversight of GSLP financial intermediaries. Finally, the Department must improve its procedures so that it moves quickly to audit the financial aid records of closed schools, in order to determine losses and attempt to collect monies owed to the students and/or the government.

(14) In carrying out its GSLP regulatory and oversight functions, the Department of Education must greatly expand and improve its coordination and communication with other federal agencies. The Department should seek the assistance of the Departments of Labor and Veterans Affairs in sharing mutually useful information developed pursuant to their respective job training and student aid responsibilities. The Subcommittee also received testimony that considerable GSLP abuse could be avoided if social security numbers of potential borrowers are verified before a loan is originated. Congress, therefore, should authorize the Social Security Administration to assist the Department of Education in determining if potential borrowers are using true and correct social security numbers on their student loan applications.

(15) The Department of Education must develop ways to assist those students who continue to be victimized by fraud and abuse within the GSLP. Because the Department's oversight systems have failed, students who have not received the education promised have been left responsible for loans that they cannot repay and, therefore, on which they all too often default. The Department must not only increase efforts to prevent this type of abuse in the future, but also work with students to ease financial burdens imposed as a result of past abuse.

(16) Principal participants in the GSLP—including officers, directors, employees, and consultants of schools, originating lenders, guaranty agencies, loan servicers, accrediting bodies, state licensing authorities, and secondary markets—should be required to submit formal statements to the Department of Education disclosing any interest they hold in other participating GSLP entities. The Department should closely review these disclosure statements and take appropriate action to prevent instances of potential conflict of interest. The Department should strictly enforce the regulatory requirement that accrediting agencies develop ethical standards to assure that those involved in key accreditation actions and decisions have no stake in their outcome.

(17) Congress should require participating lenders to exert due diligence in the making of a guaranteed student loan. There is no reason why, as is currently the case, a bank should be allowed to originate a guaranteed student loan without the same reasonable care and prudence it would exercise in originating its own consumer loans. In the event that loans are found to have been made in violation of this requirement, the Department should not pay claims on those loans.

If the reforms recommended by the Subcommittee do not dramatically curtail the level of abuse found in this investigation, Congress should consider requiring lenders to share some of the risk in originating federally guaranteed student loans. Under a prospective risk sharing arrangement, instead of being reimbursed 100 percent, as they are presently, participating GSLP leaders would have to assume some portion of any defaulted loan loss.

(18) The Department of Education should prohibit participating GSLP lenders from selling the promissory note for a guaranteed student loan until after the entire loan has been disbursed. Lenders should also be required to wait a specified time to allow for receipt of cancellations or refunds prior to sale of the loan. Further,

the borrower should be notified of the details of the sale by both the seller and buyer of the loan. Currently, borrowers frequently do not know who ultimately holds their loan, complicating repayment efforts and increasing the likelihood of default.

(19) Congress should consider requiring state and federal financial institution regulatory authorities to share with the Department of Education information pertaining to participating GSLP lenders. The Department should review pertinent information obtained from these authorities when determining whether a lender may participate in the program. Similarly, the Department should immediately notify appropriate state and federal authorities when deficiencies in a lender's program are identified.

(20) The Subcommittee found that guaranty agency practices permitted under current law are overly complex and costly to the taxpayer. Guaranty agencies, for example, are not required to submit delinquent loans to the Department of Education for reimbursement. Accordingly, they often purposely delay submission of such claims from one fiscal year to the next. This practice, known as the "arbitrage game," allows guaranty agencies with high-default loan portfolios to escape intended penalties (up to a 20 percent reduction in the amount of the reinsurance paid by the government) and increases the government's reinsurance and interest subsidy costs.

In addition, once a guaranty agency submits its claim for reinsurance, present law allows it to retain the promissory note on the loan in question. As a result, a guaranty agency can continue to attempt to collect on a loan for which it has already been reimbursed. If this latter effort is successful, the guaranty agency can retain up to 35 percent of the monies recovered. In effect, there is little incentive for guaranty agencies to aggressively collect on delinquent loans, since they can continue such collection efforts even after they have been reimbursed. Indeed, the Subcommittee found that some guaranty agencies will only attempt to aggressively collect on loans when they are experiencing cash-flow problems and, moreover, that they use defaulted loan promissory notes as weighted collateral in order to obtain additional financing for their business operations.

Accordingly, the Subcommittee recommends that Congress should:

require guaranty agencies to submit reinsurance claims to the Department within a specified and limited period of time to eliminate abuse evident in the "arbitrage game."

mandate that once a guaranty agency submits a reinsurance claim, it must surrender the promissory note to the Department of Education in order that further and immediate collection activity be undertaken. In addition, in the event that the Department is able to successfully collect on a defaulted loan that a guaranty agency had failed to collect on, that guaranty agency should be billed for the expenses incurred by the Department in this regard.

(21) Congress should mandate that Internal Revenue Service collection and skip tracing (determining a borrower's whereabouts) efforts be conducted before a guaranty agency receives reinsurance for a defaulted loan. Presently, these Internal Revenue Service pro-

cedures are not utilized until after the reinsurance has been paid to the guarantor, effectively increasing the government's costs.

(22) The Department of Education should establish a pilot program within participating guaranty agencies and lenders to test the utility of conducting a credit check on guaranteed student loan applicants, in order to determine the extent to which potential borrowers have significant adverse credit histories. In implementing this recommendation, the Department should make use of information available from lenders who are already conducting such credit checks.

(23) The General Accounting Office should review the guaranty agency concept, examining the agencies' roles, operations, finances, and their relationship with the State governments. The General Accounting Office should examine the feasibility of alternative approaches, including:

increasing the role of guaranty agencies in GSLP oversight and licensing of schools;

strengthening federal disincentives for high default rate portfolios;

consolidating guaranty agencies regionally or otherwise; and

abolishing the guaranty agency concept.

(24) Testimony before the Subcommittee raised questions regarding the relationship between the Student Loan Marketing Association (Sallie Mae) and the GSLP, which should be addressed by the appropriate Congressional Committees. These include: should Sallie Mae, as a government-sponsored enterprise that operates profitably to a large degree because the government guarantees the loans it purchases, assume a portion of GSLP costs; and, since no federal agency presently regulates or oversees Sallie Mae's business operations or capital adequacy, should such oversight and/or regulation be established?

(25) Congress should clarify and expand the Department of Education's authority to oversee the operations of all secondary markets (e.g., Sallie Mae and the California Student Loan Finance Corporation) and loan servicing operations as they pertain to the GSLP. The Department does not review the activities of the more than 50 participating secondary market organizations and looks at the hundreds of loan services only in the limited context of lender reviews. As a result, the Department knows little or nothing about them, despite the fact that the Subcommittee's investigation showed them to be a source of major GSLP problems and abuse.

(26) The Department of Education's Inspector General should review and report to Congress on the functions and effectiveness of the Advisory Committee on Student Financial Assistance. The Advisory Committee is charged with reporting to Congress and the Secretary of Education on numerous aspects of federal student financial assistance programs; to monitor and evaluate the effectiveness of the programs; to appraise the adequacies and inadequacies of financial aid resources and services; and, to make recommendations to the Secretary. Despite its broad mandate, the Subcommittee received testimony criticizing the Committee's shortcomings, including its intentional failure to address problems of fraud, waste and abuse in the proprietary school area.

(27) Congress should require the President, with the assistance of the Secretary of Education, to report expeditiously on certain broad, underlying questions raised by the Subcommittee's investigation, but not addressed in these recommendations. These questions include: how to develop greater support and respect for skills training; how to determine what skills the Nation needs; how to promote the most effective balance between skills training and academic forms of postsecondary education; and, how to develop the most useful balance between loans and grants in federal student financial aid programs.

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The following Senators, who were members of the Permanent Subcommittee on Investigations at the time of the hearings, have approved this report:

Sam Nunn
John Glenn
Carl Levin
James R. Sasser
Herbert Kohl
Joseph Lieberman
William V. Roth, Jr.
Ted Stevens
William S. Cohen
Warren Rudman

Other Senators, who are Members of the Committee on Governmental Affairs, approving this report are:

Daniel K. Akaka

The Members of the Committee on Governmental Affairs, except those who were members of the Senate Permanent Subcommittee on Investigations at the time of the hearings, did not participate in the hearings on which the above report is based. Accordingly, they have taken no part in the preparation and submission of the report, except to authorize its filing as a report made by the Subcommittee.

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